

MINUTES (REVISED)
BOARD OF TRUSTEES OF THE
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 500
Indianapolis, IN 46204
November 8, 2002

EXECUTIVE SESSION

Trustees Present

Jonathan Birge, Chair
Richard Doermer, Vice Chair
Garland E. Ferrell
Connie R. Thurman
Nancy Turner

Others Present

Fred Biesecker, Acting Executive Director
Forrest Bowman, Jr., Attorney-at-Law
Mary Beth Braitman, Ice Miller
Ed Gohmann, PERF Legal Counsel
Bart Herriman, Governor's Office

The Board met in Executive Session to discuss matters under IC 5-14-1.5-6.1(b)(6).

REGULAR SESSION

Trustees Present

Jonathan Birge, Chair
Richard Doermer, Vice Chair
Garland E. Ferrell
Connie R. Thurman
Nancy Turner

Others Present

Elaine Beaty, McCready & Keene, Inc.
Dick Boggs, Burnley Associates
Margaret Burlingame, Barnes & Thornburg
Mary Beth Braitman, Ice Miller
Stephanie Braming, Mercer
Micah Fannin, Mercer
Bart Herriman, Executive Assistant to the Governor
Pete Keliuotis, SIS
Stephanie Rhinesmith, Special Liaison to the Governor for Public Finance
Kurt Smith, SIS
Eric Swank, Ice Miller
Doug Todd, McCready & Keene, Inc.
Scarlet Ungurean, Mercer
Jeremiah Wise, PFO

Fred Biesecker, PERF Acting Executive Director
Caroline Drum Bradley, PERF Internal Auditor
Diann Clift, PERF MIS Director
Joseph Duncan, PERF Investment Officer
Patricia Gerrick, PERF Chief Investment Officer
Ed Gohmann, PERF Legal Counsel
William Hutchinson, PERF Special Projects
Bruce Kimery, PERF Acting Chief Benefits Officer
Patrick Lane, PERF Communications Director
Tim Legesse, PERF Investments Officer
Doug Mills, PERF Chief Financial Officer
Natalia Olenina, PERF Investments Intern
Tom Parker, 1977 Fund Director
Ken Stoughton, PERF HR Director
Lynda Duncan, Minute Writer

The Board convened in regular session. A quorum being present, the meeting was called to order.

1. GLOBAL CUSTODIAN.

- a. Global Custodian Finalist Presentations. Finalists presentations included a brief overview of:
- History and organizational structure of the firm;
 - Discussion of any recent organizational changes and the bank's strategic plans for custody over the next three years;
 - Description of organizational strengths, strengths of the custodial product, and identification of service or product enhancements over the coming year;
 - Details of custody experience with other public funds;
 - Client Service – Description of servicing model proposed for PERF and the rationale for its design;
 - Operations:
 - ❑ Description of risk reduction/minimization plans as related to PERF's operations, to include:
 - Securities tracking, core accounting, accounting for alternative investments, unitization, reporting;
 - Compliance monitoring;
 - Securities lending.
 - ❑ Description of the organization's business continuity plans.

b. Presentations.

- (1) Bank of New York. The presentation was made by Patrick Curtin, Sector Executive, Plan Sponsor Services, Karolyn Ferris, Vice President, Senior Relationship Manager, and Thomas Ford, Sector Executive, Global Securities Lending.
 - PERF would be ranked within among the top 12 pension funds for which the Bank of New York provides custodian services.
 - Mr. Birge noted that the amount being charged as custodial fees appeared to be modest and asked if the bank anticipated generating money from other activities as a result of custodianship of the Fund. He was advised that the bank would look at the entire revenue stream in addition to the custody role. It was anticipated that technology would bring efficiencies in terms of delivering the services required. Mr. Birge asked if securities lending was a factor and was advised that the bank anticipated that the securities lending earnings from PERF's portfolio would increase and it was hoped that the portfolio would expand into non-US securities. Mr. Doermer asked if other income would be gleaned from other financial activities and was advised that it was hoped that possible foreign exchange trading by the managers might materialize.
- (2) Northern Trust. The presentation was given by Eli Barkhausen, senior Vice President, Public Fund Segment Head, Mike Vardas, Senior Vice President, Global Securities Lending, Angel Kan, Vice President, Relationship Manager, Kristine Ford, CFA, Vice President, Northern Trust Global Investments, Dave Cyganiak, Vice President, Custody Sales.
 - Mr. Doermer asked if Northern Trust would be relying on other sources of income to offset the cost of custodial services, e.g. securities lending. He was advised that most public funds are involved in securities lending. Custody fees would not provide sufficient funds for reinvestment and therefore, practice was to combine custody and lending for most of their clients in order to provide the bank with additional revenue and also cash returns for the client. Income would also be generated from cash-associated short-term vehicles and foreign exchange. Mr. Doermer asked about the collateral pool and was advised that for investment alternatives, when lending securities, they used commingled fund (core USA Fund) that incorporated various risk levels. He was advised that this provided a 24-hour trading capability. Being in those locations was important to transact business from where the business was being done. Mr. Doermer asked if they could utilize the value of the account more fully as a result of having more overseas offices. He was advised that this provided a 24-hour trading capability. Being in those locations was important to transact business from where the business was being done.

- (3) JP Morgan. The presentation was made by Ed Mollahan, Senior Client Executive, Robert Russo, Senior Relationship Manager, and Judson Alleyne, Accounting Manager.

b. Board Discussion.

- Mr. Birge noted that the Board had received presentations from three outstanding candidates and any one of the finalists would be capable of performing the custodial function.
- It was noted that the National City Bank (NCB) role in the JP Morgan proposal was historical and that this relationship would be more important during the transition period. Ms. Gerrick noted that JP Morgan valued NCB's knowledge of PERF's account.
- Ms. Gerrick stressed the importance of having on-line capability whereby information could be retrieved easily and quickly. Previous experience had often meant delays following an event before PERF knew its exposure. PERF's peers had been aware of their exposure within 10 minutes.
- Mr. Ferrell noted that he had been impressed with the accounting and auditing component in JP Morgan's presentation. Mr. Doermer agreed that they had made a superb presentation on those points.
- Mr. Doermer noted that the Bank of New York had been open in their intention of using the ancillary business that might be generated from their relationship with PERF.
- Some of the Trustees considered the proximity of Northern Trust (Chicago-based) and the Midwest influence were advantages. However, it was considered that JP Morgan had a broader range of products to meet PERF's current and future investment activities. e.g. derivative and alternative reporting. Mr. Ferrell noted that all three banks had integrated custodial services. It was considered that JP Morgan had developed the in-house tools to provide details of PERF's alternative exposures by fund and type of fund.
- Mr. Doermer asked if tools would be available to enable a member to call in for their account balances and which bank stood out in terms of their ability to improve the quality of service. Ms. Gerrick noted that that was a different project. The current project related to holding PERF's assets. Service would be improved by incorporating daily-unitized values, although this would not directly impact on individual Annuity Savings Accounts. The selected bank should be able to offer the capability to calculate unit values at the end of each quarter. Following completion of a planned record-keeping proposal, the custodian will be able to feed those values into a record keeper, make the calculations overnight and to produce the values the next morning.

- Ms. Thurman considered that the bank that best served the work of PERF Investments' Division should be the deciding factor, since they would have to work on a daily basis with the Custodian selected.
- Mr. Mills noted that he had been impressed with the accounting side of JP Morgan's presentation, although he concurred that the people fit of Northern Trust had been good.
- Ms. Gerrick considered that the banks were comparable in their operational capabilities, although proximity, people and management styles were also prevailing factors. Ms. Clift considered that all were technically competent.
- Mr. Doermer asked if from the technical operational aspect, and comparing JP Morgan with Northern Trust, if there were there any apparent strengths or weaknesses, e.g. would PERF be affected by the capability for trade analysis or derivatives reporting. Ms. Gerrick noted that for alternative reporting and trade analysis, JP Morgan had an internal program and a specialist assigned to assist clients. Northern Trust provides more basic information through externally developed programs.
- It was noted that securities lending seemed to be an important factor. Differences in the banks' technical capabilities to provide the current and future requirements for PERF's investments were discussed.
- Indemnification proposals were reviewed.
- Mr. Biesecker noted that with regard to the service team commitments, the JP Morgan team would be dedicated, and Northern Trust would involve two clients in addition to PERF.
- Mr. Birge noted that on the alternative investment side, JP Morgan appeared to have internal resources to provide the necessary planning tools to meet the requirements of PERF's future programs.
- Ms. Gerrick noted her willingness to continue to negotiate on some issues raised by the Trustees, e.g. indemnification rates and technical issues.
- Ms. Ungarean considered that all three banks were capable of doing the job. However, for operational issues, JP Morgan was highlighted in terms of day-to-day operational capabilities. They had been impressed by the questions received from the JP Morgan staff regarding the complexity of PERF's structure and had valued the importance of information that would be provided by National City Bank for the conversion process. It was noted that most of PERF assets were already deposited with JP Morgan. The conversion would mainly affect the fixed income side. Therefore, they would rank JP Morgan first and Northern Trust second, based on operational and transition considerations.

MOTION duly made and carried to award the Global Custodian contract to the joint bid from National City Bank as Custodian and JP Morgan Chase as sub-Custodian.

Proposed by: *Garland Ferrell*
Seconded by: *Connie Thurman*
Votes: *5 in favor, 0 against, 0 abstentions.*

2. APPROVAL OF MINUTES.

MOTION duly made and carried to approve the minutes of the October 11, 2002 Board Meeting.

Proposed by: *Garland Ferrill*
Seconded by: *Nancy Turner*
Votes: *5 for, 0 against, 0 abstentions*

3. DISCLOSURES.

Mr. Doermer - Bank One stock, details of which are on file in the office of the Executive Director.

4. BENEFITS. Ms. Turner noted that the following items had been addressed during the Benefits Administration Committee meeting that morning:

- Acting Chief Benefits Officer. Mr. Bruce Kimery, Acting Chief Benefits Officer, had been welcomed to the meeting.
- Early Retirement Initiative. Mr. Biesecker noted that this would be discussed at the next Benefits Administration Committee meeting in December concerning PERF adopting an early retirement program for its employees.

5. ADMINISTRATIVE.

a. Search Committee. Mr. Biesecker noted that the Search Committee had met on November 1, 2002. The Committee consisted of Jonathan Birge (Chairman PERF Board of Trustees), William Christopher (Executive Director, Teachers Retirement Fund), Susan Williams (Executive Director, Indiana State Office Building Commission), Bart Herriman (Governor's Office) and Richard Doermer (Vice-Chair PERF Board of Trustees). A deadline of November 25, 2002 had been set for receipt of applications for the post of Executive Director. The next Search Committee meeting would be held on December 2, 2002 when it was the intention to review a reduced number of applications. Mr. Birge noted the intention was to have a recommendation for an Executive Director for approval by the Board of Trustees at their January 10, 2003 meeting.

b. Board Meeting Dates 2003. Dates were approved as follows:

January 10, 2003
February 14, 2003

March 14, 2003
April 11, 2003
May 9, 2003
June 13, 2003
July 11, 2003
No meeting in August
September 12, 2003
October 10, 2003
November 14, 2003
December 12, 2003

It was noted that the Investments Committee meeting would be held at 9:00 a.m. on the same day of the Board meetings.

- c. SIRIS Update. Ms. Clift noted that Mr. Biesecker and Dr. Christopher of the Teachers Retirement Fund had met with the Vice President of Covansys Operations and had presented them with a list of issues to be resolved (mainly related to quality assurance, completion of the SIRIS project, and SIRIS management). With regard to quality assurance, information presented for the financial reports was not reliable and changes made to the SIRIS program sometimes caused problems with other parts of the system. PERF and TRF were unable to carry out report processing at the same time because the technology was not sufficient to meet requirements. Since the second stage of the SIRIS project had been rolled out in April 2002, there had been numerous problems with the system and PERF was now seeking a steady state of operations. Some level of success had been achieved at the November 6, 2002 meeting and action was being taken on some of the issues identified. A timeframe had been allotted to all deliverables and this would be monitored. Mr. Biesecker and Dr. Christopher would meet with Convansys in regular review sessions to ensure that these issues were resolved. It was noted that the Acting Chief Benefits Officer would also bring considerable experience to dealing with computer-related systems.
6. INVESTMENTS. Based on the discussions and recommendations made at the Investments Committee meeting that morning, the following recommendations were subsequently moved to motion and approved by the Board.
- **RECOMMENDATION:** To allocate an additional \$35 million to the Numeric Investors LP – Small Cap Value Allocation.
 - **RECOMMENDATION:** To rebalance the Police and Fire Pension Relief Plan back to target allocation of 30% Equity/70% Fixed by December 31, 2002.
 - **RECOMMENDATION** to amend the Investment Policy regarding the specific limitation on holdings, as follows:

Section 8 – The purchase of securities of any one issuer (with the exception of the US Government and its agencies) shall be limited to an initial cost of 7.5% of the market value of an Investment Manager's Portfolio. Through capital appreciation, no such holding should exceed 15.0% of the market value of the total holdings of such Investment Manager's Portfolio, unless the Board approves the exception.

Section 15 – Alternative Investment Policy, General Statements – Portfolio Construction. Issue: Maintaining program at 5% allocation after initial start-up. Amend to provide: Established target exposure expected in 5 – 7 years.

RECOMMENDATION to amend the Alternative Investment Policy and Procedures as follows:

Section 15 – Alternative Investment Policy, General Statements – Secondary Funds. Additional language added... The Fund may take advantage of opportunities in the secondary market to gain exposure to funds that have already begun drawing capital commitments and collecting management fees. Secondary purchases would be made with the following objectives:

- To gain access to a limited partnership that was not available during its initial fundraising period;
- To gain incremental return due to a discounted Partnership interest purchase price; and
- To manage the Alternative Investment program’s cash flow profile (the ‘J-curve’) by avoiding part or all of the initial period of net negative cash flows and shortening the time to distributions from the Partnership (net cash flows).

Investment Strategy and Plan Guidelines. Amend current language “Consultant bears the cost” to provide that the Fund bears the cost just as it does for outside legal counsel also noted as such in the same section”.

Investment Procedures, Investment Strategy and Plan Guidelines. Additional language added, “Staff may also consider purchasing secondary partnership interests to shorten the effective life of the partnership interest and to access attractive limited partnerships previously unavailable to the Fund during the initial fundraising period.”

Investment Procedures, Implementation Authority. Revised to provide:

- Reviews conducted on an as needed basis. Opportunities presented to the Board.

MOTION made and duly carried to approve the above-mentioned recommendations.

Proposed by: Mr. Doermer
Seconded by: Nancy Turner
Votes: 5 for, 0 against, 0 abstentions.

7. 1977 FUND. Mr. Parker provided an update on the meeting of the 1977 Fund Advisory Committee held on October 22, 2002. Items discussed were:

- Deferred Retirement Option Plan;
- Agenda for Pension Secretaries’ Seminar, October 28, 2002. Mr. Parker noted that copies of the DROP form package had been provided to the Pension Secretaries at the

Seminar. Approximately 150 people had been present. The seminar had been followed by a question and answer period. As requested by the PERF Board, the Pension Secretaries had been asked to ensure that all Line-Of-Duty (LOD) determinations forms were submitted on a timely basis.

- Revised statutes were presented at the Pension Secretaries' Seminar on the presumptives for the LOD exposure to diseases and LOD death determination criteria.

8. ACCOUNTING/FINANCIAL. Mr. Mills provided copies of the October year-to-date actual figures compared to the FY03 Budget.

- Actual administrative and investment fees for the four months year to date were \$8,617,000 against a budget of \$10,697,000. He noted that 50% the \$2 million variance was attributable to timing differences in receipt of some of the investment invoices. This would true up with the budget during the year. Other variances were attributed to delays in projects in the consulting area.
- Headcount. This was 65 compared to the budget figure of 78, resulting in the Fund being under budget for payroll/salary expenses, etc.
- SIRIS. Mr. Doermer noted that problems had been discussed earlier concerning SIRIS that was affecting some areas of benefits and accounting. Mr. Doermer asked if Covansys was being paid in spite of having so many problems. Mr. Biesecker noted that this was under discussion. Mr. Biesecker also stated that PERF had held some Covansys invoices that had not been paid.
- Consulting and Contractual Services. Figures were significantly under-budget for consulting due to timing of some of the major projects, e.g. data clean up project (Navigant Consulting). The asset liability study would follow on after completion of the actuarial audit. Mr. Mills noted that the full year budget was appropriate but the expenses had been delayed slightly in comparison to the year-to-date budgeted figures.
- Contractual Services. In addition to the SIRIS system capital project, Covansys is also contracted for maintenance of the system (\$620,000 over the last four months for those services). PERF is approximately \$200,000 over-budget on a cash basis. PERF accrues all expenses at year-end in the Annual Report. A cash basis is used for the rest of the year. Since \$220,000 of this amount had been accrued in the prior year, PERF is on budget for FY03 for this expense item.
- Investment Expense Details. The Fund is on track as far as expenses compared to budget although some of the bills have come in a little slow. PERF is actually only at 27.7% of the full year budget. Mr. Mills noted that there were different types of investments and related fee structures. The fees are higher for active managers (small cap, international, etc) and a lower fee structure on indexed funds passively managed, such as the S&P Index.
- Budget details per department were provided.

- Mr. Mills noted that the annual report had been completed and any matters arising will be discussed at the next Board meeting. Board members were given a copy of the annual report. Mr. Biesecker noted that an advance copy of the annual report had been presented at the Pension Management Oversight Commission meeting on October 23, 2002.

9. NEW BUSINESS.

New Units and Enlargements. A list of new units requesting to join PERF and requests for enlargements to existing units were provided.

MOTION duly made and carried to approve the list of new units and enlargements.

Proposed by: Richard Doermer
Seconded by: Garland Ferrell
Votes: 5 for, 0 against, 0 abstentions.

10. ADJOURNMENT. There being no further business, the meeting was adjourned.

MOTION duly made and carried to adjourn the meeting.

Proposed by: Jonathan Birge
Seconded by: Garland Ferrill
Votes: 5 for, 0 against, 0 abstentions

11. DATE OF NEXT MEETING. The next meeting of the PERF Board of Trustees will be held on Friday, December 13, 2002.